

Blowing The Whistle On SEC Whistleblower Protection

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On April 1, 2015, the U.S. Securities and Exchange Commission issued an administrative cease-and-desist order^[1] against Houston-based technology and engineering firm KBR Inc., for violating Dodd-Frank whistleblower protection Rule 21F-17 because KBR required internal investigation employee-witnesses to sign confidentiality agreements in which the employee promised not to discuss the substance of their interviews with anyone without the prior approval of KBR's legal department.

In the wake of the order, a number of commentators have noted that the SEC's action reflects the SEC's growing concern regarding the protection, and promotion, of whistleblower rights. However, for the reasons discussed below, the order also risks undermining the attorney-client privilege, particularly in connection with internal investigations. Internal investigations play a crucial role in the provision of corporate legal advice, and companies must take lawful steps to protect the privilege despite the order's implications.



Adam Lurie

SEC Rule 21F-17

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 required the SEC to establish a whistleblower program, under which individuals who voluntarily report potential securities violations to the SEC may receive monetary awards.^[2] In response to Dodd-Frank, the SEC enacted Regulation 21F in 2011, which includes an anti-retaliation provision intended to protect potential whistleblowers:

No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement ... with respect to such communications.^[3]

The SEC has asserted that this rule is "necessary and appropriate" because "efforts to impede an individual's direct communications with Commission staff about a possible securities law violation would conflict with the statutory purpose of encouraging individuals to report to the Commission."^[4]

The Order

The order is the SEC's first enforcement action under Rule 21F-17. As the order indicates, KBR

sometimes conducted internal investigations following reports of illegal or unethical conduct. KBR required employees interviewed during these investigations to sign the following confidentiality statement:

I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.[5]

The order, however, does not identify any evidence indicating that KBR employees were deterred or otherwise inhibited from whistleblowing or that KBR ever took action to prevent an employee from doing so. Instead, the order claims that KBR's practice of using this confidentiality statement was itself a violation of Rule 21F-17 discussed above.

KBR did not admit or deny the SEC's allegations. Still, the order required KBR to pay a civil penalty of \$130,000 and to cease and desist from future violations of this rule. In addition, the order noted that as part of the settlement, KBR agreed to make reasonable efforts to contact employees who signed the statement, provide them with a copy of the order, and inform them that they are not required to seek permission from KBR's general counsel before communicating with the SEC or other government agencies.

To satisfy the SEC, KBR also amended its confidentiality statement to read as follows:

Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity ... or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.[6]

Attorney-Client Privilege in Internal Investigations

Internal investigations, like those at issue in the KBR matter, play a vital role in the provision of critical corporate legal advice. For example, counsel may be called upon to advise the company, including its board and executive level employees, whether the company or its employees have violated criminal laws, or have engaged in conduct that may subject the company to serious civil liability. To provide such advice, counsel must communicate with company employees to learn the relevant facts, legal issues and related considerations. Such communications are often among the most sensitive, and companies fiercely guard them as privileged — especially from a regulator, opposing counsel, or competitor.

It is well established that communications between a company's attorneys and its employees in the context of an internal investigation are subject to attorney-client privilege.[7] This privilege belongs to the company, not to any individual employee. As Upjohn, other legal decisions, and the above discussion make clear, counsel must be able to communicate fully and frankly with company employees to achieve better compliance with the law, and to provide the company with accurate and sound legal advice.

In at least two recent cases, courts have reaffirmed the existence of the attorney-client privilege in internal investigations. First, in another case involving KBR, the D.C. Circuit relied on the attorney-client privilege to vacate a district court order requiring KBR to produce internal-investigation-related materials in discovery.[8] Similarly, in recent multidistrict litigation involving General Motors, the district court ruled that interview notes from an internal investigation were protected by both attorney-client privilege and work product doctrine even though the company's outside counsel had written a public report describing facts uncovered during the investigation.[9] These decisions demonstrate that courts continue to recognize the importance of the privilege in connection with internal investigations.

The Order Risks Undermining Privilege and Well-Established Enforcement Policies

Despite this recognition, and well-established SEC and U.S. Department of Justice policies intended to preserve the privileged nature of company investigative materials, the order risks undermining the privilege. Specifically, the order risks employees disclosing confidential communications with counsel as they also report potential misconduct to the SEC.

The attorney-client privilege protects only attorney-client communications, not disclosure of the underlying facts.[10] Nevertheless, the order contains no express recognition of a company's interest in protecting such confidential communications. To the contrary, the order indicates that a company may not even require employees to provide the company with notice of an intended disclosure to the government. Accordingly, companies will have substantial difficulty ensuring that employees disclose only facts, not privileged communications, to the SEC — a distinction that many employees may not appreciate. Thus, the SEC's order may result in the SEC improperly receiving a company's privileged communications.

For this reason, the order also undermines well-established SEC and DOJ enforcement policies. For example, the SEC Enforcement Manual requires the SEC director or deputy director of enforcement to approve staff-sought waivers of attorney-client privilege or work product protection, and further explains that "a party's decision to assert a legitimate claim of privilege will not negatively affect their claim to credit for cooperation." [11] Likewise, the U.S. Attorneys' Manual emphasizes the importance of preserving corporate privilege, explaining that waiver of privilege "has never been a prerequisite under the department's guidelines for a corporation to be viewed as cooperative." [12]

Furthermore, the USAM dictates that "prosecutors should not ask for such waivers and are directed not to do so." [13] The USAM explicitly cites investigative interviews as an example of material that may be protected by privilege, work product doctrine or both. [14] Consequently, the order is arguably contrary to the very SEC (and DOJ) policies intended to protect privileged communications.

Recommendations in Light of the Order

Because of the order, companies should re-examine any of their internal investigation-related confidentiality provisions to ensure they are consistent with the order. To limit the risk that employees will disclose confidential communications, companies should at least consider the following:

- To the extent a company uses confidentiality agreements containing language expressly permitting disclosure to the government, make clear that employees may not disclose privileged communications with company counsel, but only facts, to the government.

- To the extent a company elects not to use confidentiality agreements, be sure to advise employees — consistent with Upjohn — that conversations between company counsel and the employee are privileged, that the privilege belongs to the company, and that only the company may waive that privilege.
- Assess carefully what information, if any, to disclose to employees regarding the allegations at issue in an internal investigation.

Consistent with these steps, before their privileged communications end up in the wrong hands, companies should assess their internal investigation-related practices, and should balance their obligation not to deter whistleblower disclosure with their right to protect their privileged communications. In the meantime, to ensure that its whistleblower program is fair, the SEC should consider establishing rules intended to minimize the risk that the SEC will receive privileged communications from whistleblowers; for example, rules that require SEC staff to advise whistleblowers not to disclose a company's privileged communications, and which ensure that whistleblower disclosure of a company's protected communications will not operate as a waiver of privilege by the company whose employee made disclosures to the government.

—By Adam Lurie, Jodi Avergun and Katy Preston, Cadwalader Wickersham & Taft LLP

Adam Lurie is a partner in Cadwalader's Washington, D.C., office and a member of the U.S. Sentencing Commission's Practitioners Advisory Group. He was senior counsel to the assistant attorney general at the DOJ's Criminal Division from 2010 to 2012.

Jodi Avergun is a partner in the firm's Washington office and former chief of staff of the U.S. Drug Enforcement Administration.

Katy Preston is an associate in the firm's Washington office.

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[1] In re KBR Inc., No. 3-16466 (Apr. 1, 2015), available at <http://www.sec.gov/litigation/admin/2015/34-74619.pdf>.

[2] 15 U.S.C. § 78u-6.

[3] 17 C.F.R. § 240.21F-17(a).

[4] SEC, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, available at <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

[5] In re: KBR, Inc. at 2.

[6] Id. at 3.

[7] *Upjohn v. United States*, 449 U.S. 383 (1981).

[8] See *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014) (finding clear and indisputable error in narrow district court interpretation of attorney-client privilege and granting writ of mandamus).

[9] See *In re General Motors LLC Ignition Switch Litig.*, — F. Supp. 3d —, 2015 WL 221057 (S.D.N.Y. Jan. 15, 2015).

[10] E.g., *Upjohn*, 449 U.S. at 395.

[11] SEC Enforcement Manual § 4.3, available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

[12] U.S. Attorneys' Manual § 9-28.710, available at <http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations>.

[13] *Id.*

[14] *Id.* § 9-28.760(a) n.3. In fact, the USAM acknowledges that “certain notes and memoranda generated from the interviews” may be privileged and states that for the purpose of cooperation credit, “the corporation need not produce, and prosecutors may not request,” these types of privileged materials. *Id.* (emphasis added).
